

2024 US Elections and its implications on the markets

30 May 2024

Overview

- The US Elections (5 Nov 2024) warrant investors' attention
- Focus is on trade, foreign, regulation and fiscal/tax policies
- Premature to call election outcome based on polling status
- Expect a tight race ahead but Biden stands a good chance
- Electoral College votes to determine outcome, not popular
- A divided Congress is the consensus expectation for now
- Expect more US friend-shoring and domestic manufacturing
- Markets volatile prior to elections, but higher post-elections
- Fiscal spending could impact term premium and policy rates
- Implications for equities are country-, sector- and theme-led

Why the US elections warrant investors' attention

The US Elections set for 5 Nov 2024 will have significant market implications given that a loss for the incumbent Democrats could mean major changes in trade policy (e.g., US-China), foreign policy (e.g., Russia-Ukraine, Middle East-Israel), regulation (e.g., energy/environment, antitrust) and fiscal/tax policy (e.g., Tax Cuts and Jobs Act (TCJA) sunset in end-2025).

Figure 1: Scope and scale of tariffs under 2nd Trump presidency

Actual and potential tariff policies under President Donald Trump			
Policy	Scope	Trump 2018-19	Potential Trump 2nd term
Tariff (all imports)	World	None	10%
Tariff on imports from China	China	7.5%-25% on ~\$350bn	Additional 60%+*
Permanent normal trading relations (PNTR) status	China	Ongoing	Terminated
De minimus exception**	World	\$800	Reduced sharply/eliminated

* In this paper, we model an additional 60% tariff on all US imports from China, though in practice average tariff levels could be very different than this figure.

** Threshold value under which an individual import shipment to a given recipient is not subject to duty.

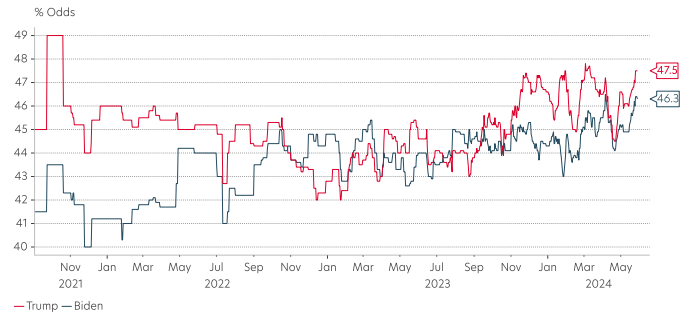
Source: Bloomberg, US International Trade Administration

With the former US President Trump suggesting a 60% tariff on imports from China (Fig. 1), and President Biden proposing sharp tariff hikes on imports of China's EV-related goods, solar panels, semiconductors as well as steel and aluminium, the US political rivalry is heating up in the presidential candidates' bid to garner votes. Given the rising geopolitical and policy uncertainties, it is critical to gain insights on where we stand in the lead-up to the US Elections, and the investment implications in an election year.

Premature to call the outcome based on polling status

Based on the latest polling status, one could conclude that Donald Trump is likely to oust Joe Biden to be the next US President. As of 30 May 2024, Trump has been maintaining a marginal lead over Biden since end-2023, according to the RealClearPolitics (Fig. 2).

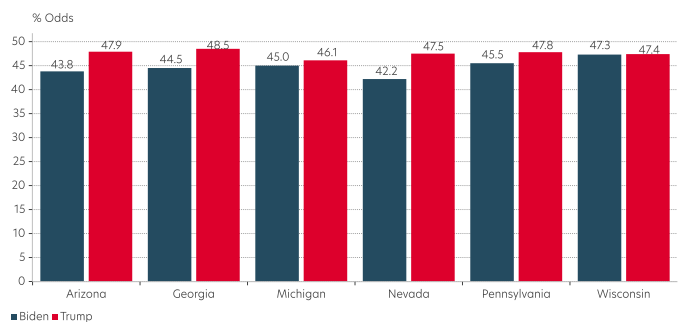
Figure 2: A tight presidential race ahead - Trump leads slightly



Source: Macrobond, UOB Private Bank, RealClearPolitics (RCP)

Similarly, in the swing states, also known as toss-up states which have a history of flipping red or blue depending on an election, Biden continues to lag Trump (Fig. 3).

Figure 3: Trump has a marginal advantage in swing states



Source: Macrobond, UOB Private Bank, RealClearPolitics (RCP)

However, it would be premature and naïve to call the outcome based on polling results; the polls are simply snapshots of the current stage instead of predictors. The polling errors are far greater than what one would expect. In addition to statistical error, pollster may be provided with misleading answer by the sample audience. As such, poll results have little predictive power, especially if we are far out from the US Elections.

Despite an ostensible disadvantage, fundamentals suggest that a lot would have to go wrong for Biden to lose the presidency.

When it comes to US elections, Allan Lichtman, a professor at American University in Washington D.C., almost always gets it right; he has accurately predicted 9 of the last 10 presidential elections since 1984. Professor Lichtman developed a metric, which he calls the "13 Keys to the White House" (Fig. 4). If any six or more of the keys are false, the party in the White House loses. If fewer than six are false, the White House party wins.

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Figure 4: A lot would have to go wrong for Biden to lose

No	Key	Description	Note
1	Party Mandate	After the midterm elections, the incumbent party holds more seats in the U.S. House of Representatives than it did after the previous midterm elections.	False
2	No Primary Contest	After the midterm elections, the incumbent party holds more seats in the U.S. House of Representatives than it did after the previous midterm elections.	True
3	Incumbency	After the midterm elections, the incumbent party holds more seats in the U.S. House of Representatives than it did after the previous midterm elections.	True
4	Third Party	After the midterm elections, the incumbent party holds more seats in the U.S. House of Representatives than it did after the previous midterm elections.	Shaky
5	Short-term Economy	After the midterm elections, the incumbent party holds more seats in the U.S. House of Representatives than it did after the previous midterm elections.	Leans True
6	Long-term Economy	After the midterm elections, the incumbent party holds more seats in the U.S. House of Representatives than it did after the previous midterm elections.	Leans True
7	Major Policy Change	After the midterm elections, the incumbent party holds more seats in the U.S. House of Representatives than it did after the previous midterm elections.	True
8	No Social Unrest	After the midterm elections, the incumbent party holds more seats in the U.S. House of Representatives than it did after the previous midterm elections.	Shaky
9	No Scandal	After the midterm elections, the incumbent party holds more seats in the U.S. House of Representatives than it did after the previous midterm elections.	Leans True
10	No Foreign/Military failure	After the midterm elections, the incumbent party holds more seats in the U.S. House of Representatives than it did after the previous midterm elections.	Shaky
11	"Major Foreign/Military Success"	After the midterm elections, the incumbent party holds more seats in the U.S. House of Representatives than it did after the previous midterm elections.	Shaky
12	Incumbent Charisma	After the midterm elections, the incumbent party holds more seats in the U.S. House of Representatives than it did after the previous midterm elections.	False
13	Uncharismatic Challenger	After the midterm elections, the incumbent party holds more seats in the U.S. House of Representatives than it did after the previous midterm elections.	Leans True

Source: Goldman Sachs FICC & Equities

While certain notes are debatable, it is worth noting there are four keys on shaky foundations. At least 5% popular vote is deemed to be significant, and Robert F. Kennedy Jr. is trending in third-party vote (Note #4). Recent campus protests have emerged recently, but whether they are sustained remain to be seen (Note #8). Considering what is happening in Middle East and Ukraine, Notes #10 and #11 would be worth monitoring.

Electoral College votes to determine outcome, not popular

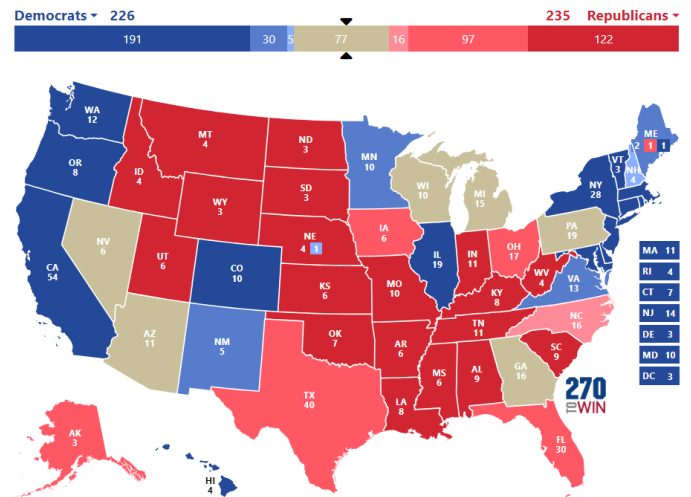
The US Electoral College is the group of presidential electors that is formed every four years for the sole purpose of voting for the US President and Vice President. Of the current 538 electors, a simple majority of 270 or more electoral votes is required to elect the President and Vice President.

Back in 2016, Donald Trump defeated former Secretary of State Hillary Clinton, taking in 304 electoral votes to Clinton's 227 votes. However, Clinton took in 2.8 million more popular votes. In the upcoming US elections, electoral votes will be key in determining the Presidential outcome, especially in swing states.

2020 was an outlier for the Democrats; they won in all six swing states. This had never been the case in the last two decades.

Looking ahead, the 2024 consensus points to material toss-up in the electoral votes, suggesting it will be tough to call the US presidential election outcome (Fig. 5).

Figure 5: Hard to call the outcome with lots of toss-up (sand)



Source: 270twin, map updated as of 18 May 2024

In this vein, it is essential to consider the top issues on the voters' minds. According to J.P. Morgan, the economy remains the top issue for swing-state voters, while a growing share of voters are identifying immigration as a top issue for the 2024 elections.

Voters generally favour having the Republicans in place to cope with inflation (economic issue) based on polling results, but the broad disinflationary trend remains intact and could steer the focus away to other concerns later this year. Having said that, voters could still be frustrated with high-for-longer borrowing costs and perceive that the US economy is getting worse.

It is also worth noting that Generation Z (born between 1997 and 2012) comprises ~20% of the eligible voting population and prioritises issues including climate change and gun violence prevention. Based on the CIRCLE Pre-2024 Election Youth Survey, these youths are most likely to vote for Democrats. Moreover, Trump faces some fundraising challenges for his presidential campaign, given the resource drain from the ongoing litigation by Manhattan D.A. against him in falsifying business records.

A divided Congress is the base case for now

The consensus is looking at a divided Congress for now, with the Republicans likely to retake the Senate based on market-implied odds. However, the Democrats are polling ahead in most of the seats they currently hold. Meanwhile, control of the House is narrowly divided, with the odds tilted in the Democrats' favour.

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While fiscal stimulus may arguably be harder to come by under divided-government outcomes, fiscal budget deficit as share of GDP has been on the rise over the last two decades. Having said that, having unified governments can unlock more significant impacts given that more transformative policies are likely to be implemented under a Democratic or Republican sweep scenario.

US foreign policy: A competitive confrontation with China

The US President holds significant discretion when it boils down to foreign policy, which makes predicting geopolitical outcomes immensely difficult. Having said that, maintaining a hawkish tone on China is one of the few areas of bipartisanship in the US. Since 2021, President Biden has mostly maintained former President Trump's strategy with respect to China, primarily via measures like tighter export controls and non-tariff barriers.

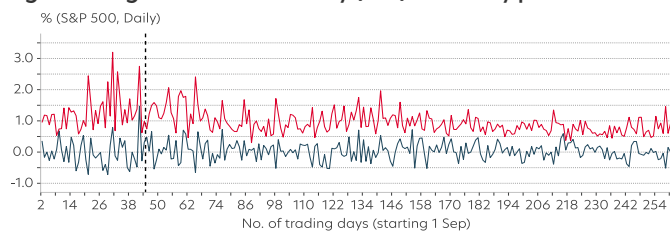
Going forward, one can expect the US to be in a competitive confrontation with China, which is characterised by continued US friend- and re-shoring as well as investments in domestic production (high offense), and deployment of non-tariff investment restrictions (high defense). It is imperative that China refrains from escalating trade tensions herein despite facing potentially substantial US tariffs; the broad economic context for China is different now versus that during the 2018-19 episode.

First, the Chinese economy is no longer benefiting from a Covid-era export surge. Second, the Chinese government needs to deal with a housing slump and depressed consumer sentiments. Third, other large economies are also considering tariffs on Chinese goods. Finally, multinational corporations are now more focused than ever on supply chain resilience as well as geopolitical risks besides tariffs. A tit-for-tat US-China trade war would spell trouble for China at a time when external threats are prevalent while domestic issues need to be dealt with great urgency.

Higher volatility prior to election but will settle thereafter

The US Federal Reserve is independent, but it is not entirely free from political pressures. In this regard, higher market volatility can be reasonably expected for ~2 months in the lead-up to the US elections (Fig. 6), given the uncertainties introduced to the US fiscal and monetary policies because of the election outcome.

Figure 6: Higher market volatility (S.D.) to steady post-election

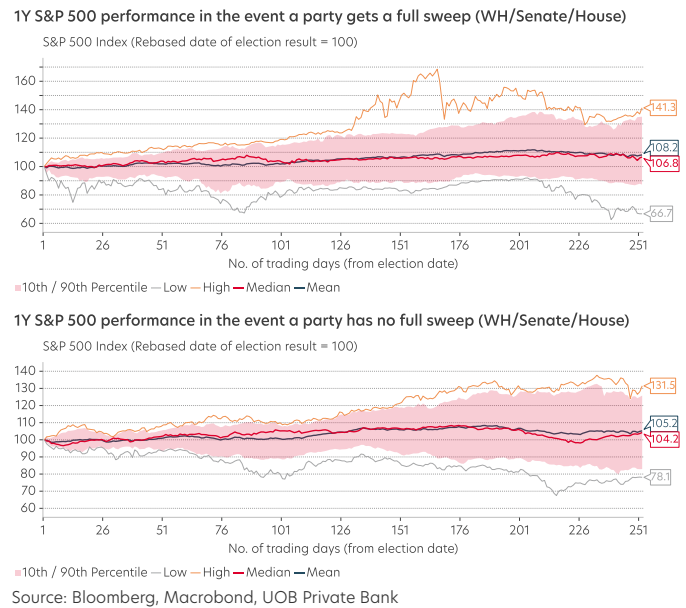


Source: Bloomberg, Macrobond, UOB Private Bank

Investment takeaways for a US election year

It is noteworthy that markets (as proxied by the S&P 500) tend to go up in the one year right after a US election. Unsurprisingly, markets tend to end higher under a Democratic or Republican sweep scenario than under a divided government (Fig. 7).

Figure 7: Markets up post-election, but higher under full sweep



Against this backdrop, a window of tactical trading or buy-on-dip opportunities could open ~2 months (starting Sep) prior to the elections. Historically, the US dollar would strengthen due to haven demand amid rising policy uncertainties. Beyond the Asian currencies, the Mexican Peso, the Euro, and Chinese Yuan are especially vulnerable given their high nominal trade surplus with the US which render them susceptible to the US tariffs.

For bonds, higher fiscal expenditure could impact term premium and the Treasury curve steepness. It could also mean high policy rates for longer albeit the pass-through to inflation is uncertain.

The implications for equities are country-, sector- and theme-led.

In terms of Asian market and sector performances, South Korea, Taiwan, and India, as well as the tech sector tend to perform the best in the one year after the US election date. For the US, targeted government spending in the defence and healthcare sectors, tax cuts or tariff hikes, looser or stricter antitrust laws as well as energy-related policies will favour companies exposed to a particular theme over the others, depending on the election outcome. Clients can consider gaining exposure to structured products which can benefit from great performance dispersion in any two baskets of stocks e.g., a basket leveraged to Biden's win versus another basket that taps into Trump's win.

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